

Internal Revenue Service
memorandum

CC:TL-N-5890-91
Br2:SMJannotta

date: JUL 10 1991

to: District Counsel, San Diego CC:SD
Attention: June Y. Bass

from: Assistant Chief Counsel (Tax Litigation) CC:TL

subject: Extension of Statute for Section 4999 Excise Taxes

Taxpayer: [REDACTED]

This responds to your request dated April 10, 1991, for Tax Litigation advice in the above-referenced matter. Although the issues raised in your request for advice do not constitute ISP issues, we understand that this case arises out of an LBO audit. Thus, resolution of these issues may be of interest to the Leveraged Buy-Outs Industry. Because the questions present issues of first impression under sections 280G and 4999, this matter was coordinated with Technical.

Issues

1. What is the proper procedure for securing a consent to extend the statute of limitations for assessing the excise tax on "golden parachute payments" imposed by I.R.C. § 4999.
2. Under the facts and circumstances set forth in your memorandum, who can execute said consents.

Conclusions

1. We have identified three separate tax liabilities as to which consents may be obtainable. These liabilities are: (1) the excise tax under section 4999 which is imposed on the recipient of the excess parachute payment; (2) the withholding requirement under section 4999(c)(1) which is imposed on the employer where the excess parachute payments constitute wages; and, (3) the income tax resulting from the disallowance of the deduction to the employer/payor for amounts which constitute excess parachute payments. A modified Form 872 or modified Form 872-A may be used to extend the period of limitation with respect to the recipient's liability for the excise tax. A modified Form SS-10 or a Form 872-B may be used to extend the period of limitation with respect to the withholding obligation imposed on the employer. A Form 872 or a Form 872-A may be used to extend the

09543

period of limitation with respect to the corporate income tax liability arising out of the improper deduction of excess parachute payments.

2. The individual recipients of the excess parachute payments would be the proper persons to extend the period of limitation for their respective liabilities. If joint income tax returns are involved, consents should also be signed by their spouses. The corporate employer for whom the services were rendered would generally be considered the employer for purposes of the withholding obligation on excess parachute payments which also constitute wages. Therefore, that consent should be signed by an officer of the corporate employer. However, if the payor of the golden parachute payment is not the corporation for whom the recipient of the golden parachute payment performed the compensable services as employee, we also recommend that a consent with respect to the employer's withholding tax liability under subsection 4999(c)(1) be obtained from the payor.

Because the corporations here filed income tax returns on a consolidated basis, the common parent of the affiliated group is treated as the sole agent for the group in all matters relating to the group's income tax liability for a consolidated return year. The determination of who may sign the consent to extend the period of limitation for the corporate income tax liability arising from the disallowance of the deduction attributable to the excess parachute payment should be made in accordance with Treas. Reg. § 1.1502-77.

Background

Our assistance was requested by District Counsel attorney June Bass with respect to who is the proper party to sign a consent to extend the statute of limitations for assessment of the excise tax imposed under I.R.C. § 4999 on excess parachute payments. District Counsel concludes that the excise tax is treated as an income tax under Subtitle A subject to withholding at the source and, therefore, Form SS-10 should be used. Further, District Counsel concludes that, because the employer corporations involved filed their own respective employment tax returns, the proper party to execute the Form SS-10 is any duly authorized officer of the employer corporation. For the reasons set forth below, this office disagrees in part with the conclusions reached by District Counsel.

Facts

The facts have been taken from District Counsel's memorandum, dated April 10, 1991, unless otherwise stated. [REDACTED] acquired [REDACTED] which franchises [REDACTED] style restaurants. [REDACTED] also operates and franchises "[REDACTED]" fast food restaurants. Such acquisition took place on [REDACTED]

██████████, when ██████████ acquired all of the outstanding shares of ██████████'s common stock. As a result, ██████████'s cancelled outstanding stock options (pursuant to the termination of its nonstatutory ██████████ plan) at a cost of \$██████████. In addition, ██████████'s made severance payments to officers, directors, supervisors and other nonexempt employees who were terminated. These amounts were expended during ██████████, ██████████ and ██████████ of ██████████.

In ██████████, ██████████'s outstanding stock was purchased by ██████████ in a leveraged buyout. ██████████ was a wholly owned subsidiary of ██████████. Immediately thereafter, ██████████ was merged into ██████████ with ██████████ surviving. Because of the leveraged buyout, all outstanding stock options under ██████████'s nonstatutory ██████████ and ██████████ plans (including reinvested options) were cancelled for present or future cash payments. We have been advised by District Counsel attorney June Bass that cash payments were made pursuant to this termination in ██████████ and ██████████ of ██████████. The plans, by their terms, were terminated upon a change in ownership or control.

The options under both the ██████████ and ██████████'s plans contained restrictions on transfers and, therefore, could not actively be traded on an established market.¹ Further, the corporations terminating the options withheld income taxes on the cash payments actually made. The corporations deducted the amounts expended to terminate the options and to make the severance payments. We have been advised by District Counsel, San Diego, attorney June Bass that all relevant payments considered to be excess parachute payments were made to employees and that such payments were properly viewed as wages.

Although the corporate employers filed their own respective employment tax returns, we have been advised by District Counsel, San Diego, attorney June Bass that consolidated income tax returns were filed by ██████████ and ██████████'s for the taxable years ██████████ through ██████████ and ██████████ through ██████████ as well as by ██████████, ██████████ and ██████████'s after the leveraged buyout for the taxable year ending ██████████.

¹ Although a readily ascertainable value for the stock may not be determinable under section 83, for purposes of sections 280G and 4999 the present value of payments treated as contingent on a change in ownership or control may still be determined. See, e.g., Prop. Treas. Reg. § 1.280G-1, Q&A #24.

Analysis

Issue 1. What is the proper procedure for securing a consent to extend the statute of limitations for assessing the excise tax on "golden parachute payments" imposed by I.R.C. § 4999.

Section 4999 imposes an excise tax on the recipient of an excess parachute payment. I.R.C. § 4999(a). The tax is 20% of the excess parachute payment. Id. For purposes of section 4999, the term "excess parachute payment" is given the same meaning as used in subsection 280G(b). I.R.C. § 4999(b). An excess parachute payment generally means "an amount equal to the excess of any parachute payment over the portion of the base amount allocated to such payment." I.R.C. § 280G(b)(1). The term "parachute payment" is defined in subsection 280G(b)(2). For purposes of our discussion, we have assumed the existence of excess parachute payments.

Subsection 4999(c) sets forth administrative provisions for dealing with excess parachute payments. Where the excess parachute payments also constitute wages within the meaning of section 3401, the excise tax is to be deducted and withheld (and added to the amount otherwise deducted and withheld under section 3402). I.R.C. § 4999(c)(1). Section 3401 generally defines wages for purposes of Chapter 24 (Collection of Income Tax at Source on Wages) to include all forms of remuneration for services performed by an employee for his/her employer. I.R.C. § 3401(a). For purposes of our discussion, we have assumed that the excess parachute payments at issue here constituted wages within the meaning of section 3401.

Although the excess parachute payments at issue here may be wages subject to a withholding requirement, the excise tax is imposed on the recipient of the excess parachute payments whether or not such payments come within the definition of wages under section 3401. Further, under the normal rules for income tax withholding, an employee remains liable for the correct amount of any income tax due on wages even though the employer may have failed adequately to withhold such tax on those wages.²

² Analogously, an employer's failure to withhold the 20% excise tax coupled with the employer's later satisfaction of that liability would be (at least if accomplished within the same taxable period) additional wages to the recipient within the meaning of sections 3401 and 3402. Conversely, a recipient's personal payment of the excise tax coupled with an employer's failure to withhold the excise tax as required under subsection 4999(c)(1) relieves the employer of the obligation to payover the actual tax but would not relieve the employer of the liability for any determined penalties and interest with respect to the withholding requirement. See Treas. Reg. § 31.6205-1.

Accordingly, it is the individual recipient who may extend the period of limitation for assessment of the excise tax imposed by section 4999. As a tax imposed under Subtitle A, either Form 872 or Form 872-A may be used to extend the period for assessment. Language sufficient to identify that the consent relates to the excise tax must be included (e.g., "excise tax under section 4999 of the Code"). If the consent will have a dual purpose (i.e., to extend the period of limitation for both the excise tax and income tax), the descriptive language must sufficiently identify both types of tax.

There is, however, a duty imposed upon an employer to withhold income taxes on wages. I.R.C. § 3402. The employer remains liable for the correct amount of withholding. I.R.C. § 3403. Withheld income tax is generally reported on the employer's Form 941 for the quarter in which the wages were paid. Because of section 3403, the employer, who paid wages within the meaning of section 3401 but failed to properly withhold tax as required by section 3402, will also remain liable for the payment of such tax.³ Similarly, by virtue of subsection 4999(c)(1), the excise tax imposed on the recipient of the excess parachute payment is also a "collected tax," with the responsibility falling on the employer to withhold the correct amount from the recipient's wages. Thus, where the excess parachute payments are treated as wages, the employer will also continue to be liable for the payment of the amount of the excise tax which should have been withheld.

Either Form SS-10 or Form 872-B can be used to extend the period of limitations with respect to the excise tax withholding liability. The consents would relate to the Form 941 for the taxable quarter(s) in which the parachute payments were made. If Form SS-10 is used, however, it should be modified by adding descriptive language to the top of the form which identifies the

³ We note that there may be a factual issue with respect to determining who is the employer in some instances because the actual payment of the golden parachutes may be done by a party other than the party for whom the services underlying the golden parachute payments were performed. The definition of employer in section 3401 appears broad enough to encompass both the party for whom the services were initially rendered and the party controlling the payment of the golden parachutes if those parties differ. See I.R.C. § 3401(d).

types of taxes covered by the consent to clearly identify the excise tax imposed under section 4999. Where there exists the possibility that more than one corporation may be deemed to be the employer (e.g., where the employee performed services for one corporation but another corporation such as the parent or the acquiror actually paid the parachute payments), a Form SS-10 or Form 872-B should be executed by each potential employer.

Because the corporation(s) making the parachute payments apparently deducted the entire amount of such payments on the corporate income tax returns for the years of payment, there is also the liability for the increase in income tax due to the disallowance of that portion of the deduction attributable to the excess parachute payments. Either Form 872 or Form 872-A may be used to extend the period of limitation with respect to the corporate income tax liability arising out of the improper deduction of excess parachute payments.

Issue 2. Under the facts and circumstances set forth in your memorandum, who can execute said consents.

Since we conclude that the taxpayer (for purposes of section 4999) is the recipient, it follows that any consents to extend the time to assess the actual excise tax imposed by section 4999 should be executed by the individual recipients. Where a recipient has filed a joint income tax return for the year in which the excess parachute payment was received, both the recipient and the recipient's spouse should sign the consent. As stated above, the consent should explicitly identify the excise tax. Where the consent will be used to extend the assessment period for both income and excise taxes, the consent should explicitly identify both taxes.

With respect to extending the period for assessing the employer's continuing liability under section 3403, the consent may be executed by any duly authorized officer of the corporate employer which paid the wages and on which the obligation to withhold fell. We believe that, for purposes of withholding the excise tax on excess parachute payments which constitute wages, it is reasonable to assume the definition of employer under section 3401(d) will apply. As noted above, if Form SS-10 is used, it should be modified to clearly identify the excise tax liability under section 4999.

Where the parent has also been given power of attorney to act for its subsidiaries with respect to all matters involving the excess parachute payments, including the employer's withholding obligation, the procedures set forth in Rev. Proc. 72-38, 1978-2 C.B. 813, as clarified by Rev. Proc. 82-6, 1982-1 C.B. 409, may be used to obtain one consent covering all affected members of the group.

With respect to extending the period for assessing the income tax liability arising from the disallowance of the deduction for that portion of the golden parachute wage payment which constitutes an excess parachute payment, consents should be generally be signed by a duly authorized officer of the common parent as agent for the group, pursuant to Treas. Reg. § 1.1502-77.

Please call Tina Jannotta at (FTS) 566-3470 if there are any questions.

MARLENE GROSS

By:

Steven J. Hankin
STEVEN J. HANKIN
Senior Technician Reviewer
Branch No. 2
Tax Litigation Division